RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Post Office Box 1759, La Jolla, California 92038

26 Letters Per Year • $250 annually

Jan. 19, 1994 **LETTER 1139**

QUESTIONS & ANSWERS: Question: In view of your rather unexpected "blow-off" scenario as put forth in the last Letter, what do you think of the stock market's action so far in January?

Answer: Under the leadership of the D-J Industrials and Transports, the market has been showing signs of acceleration on the upside. Everything I said in the last Letter still holds. Nothing has changed. My Primary Trend Index (PTI) continues to hit new highs, the advance-decline ratio is working its way upwards, the massive short interest on the NYSE remains intact, the negative volume index is still rising, margin accounts are at the high, nervousness and,last but not least, anxiety and skepticism are still the prevailing sentiments. It's increasingly obvious that the bears and the short sellers are positioned on the wrong side of the market.

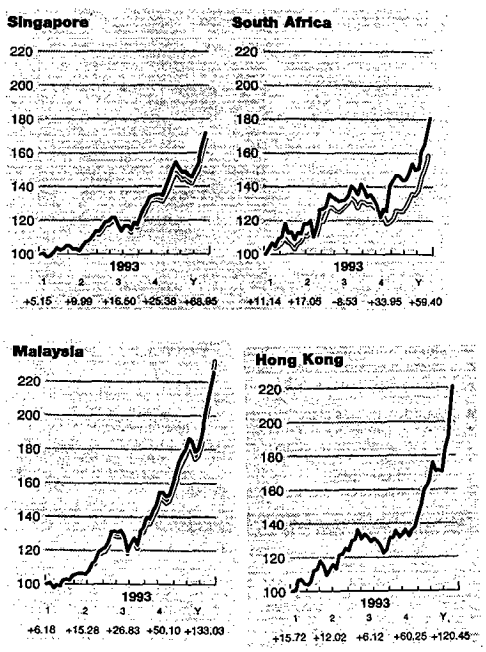
I can't emphasize this enough -- there's nothing more powerful than a bull market that is being re-confirmed and re-confirmed again by the D-J Averages -- this in the face of skepticism, warnings, doubts, and a record short interest.

On top of that, we have the spectacle of my PTI pushing to new highs almost daily, we have the advance-decline ratio near new highs, and we have a market that is volatile and powerful on the upside but feeble, tentative and unconvincing on the downside.

Against the super-low volatility of 1992 and 1993 we're now entering 1994, and the big question is -- will this be a third very low volatility year? Personally, I doubt it.

A lot of subscribers are undoubtedly skeptical of my blow-off thesis -- for that matter, most subscribers don't even know what a blow-off in a stock market looks like. Let me show you.

The accompanying charts (courtesy of the London *Financial Times*) depict four markets that blew-off or exploded only last year. Singapore and S. Africa advanced over 70% and Malaysia and



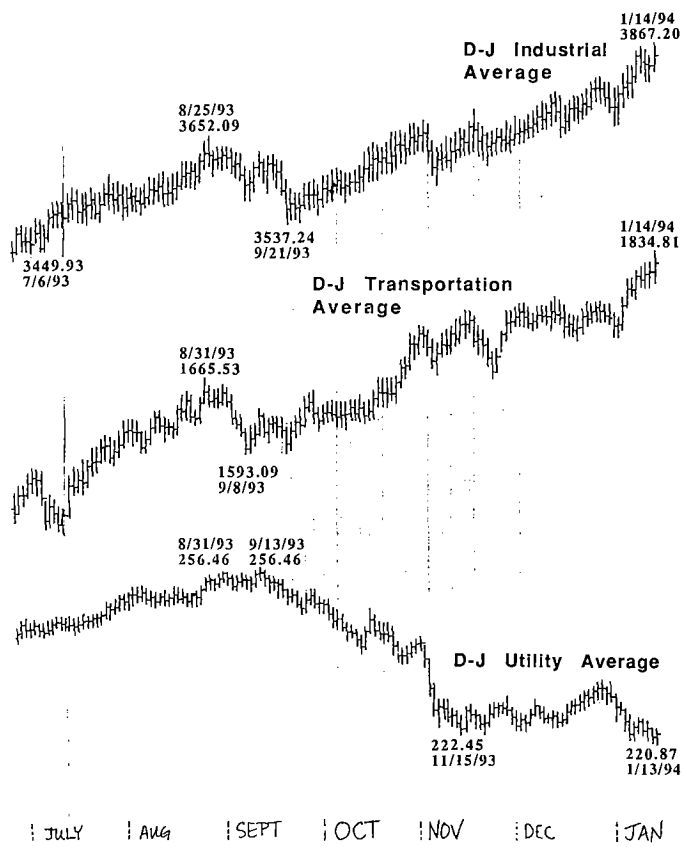
Jan. 7 DJIA 3820.77; PTI 4054; A-D Ratio -2.23
Jan. 14 DJIA 3842.43; PTI 4066; A-D Ratio -1.95
Dow Yield: 2.81%; Dow Price/Earnings: 35.5
Dow 200-day MA: 3587; Dow 30-day MA: 3754
Dow Times Book Value: 3.37; PTI 89-day MA: 3984
Percentage of Undervalued Blue-chips: 8%
Dow Low Risk Buy Index: +110; Gold-PTI: 1115

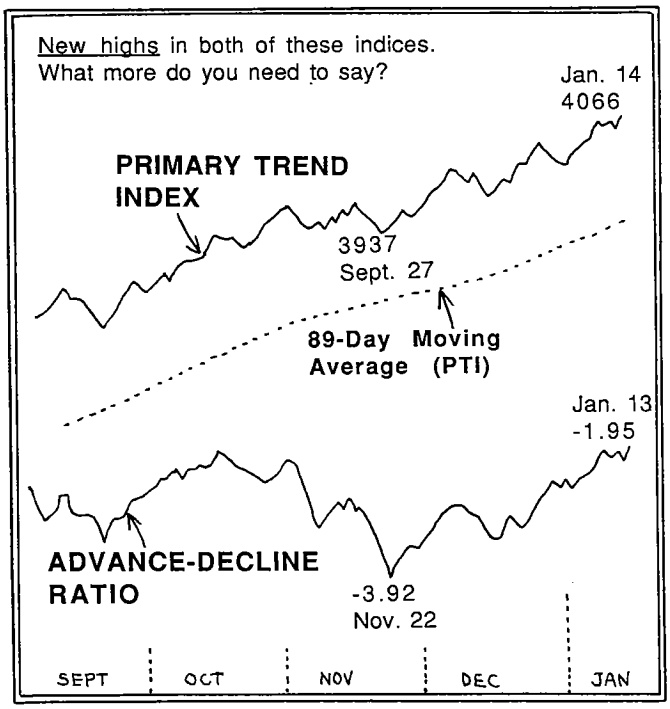
Hong Kong rose well over 100%. If the US market in 1994 acts anything like these four markets did in 1993, we would indeed be witnessing a blow-off market. Could it happen? We'll see.

If our market does blow-off on the upside, I'm guessing that we are in for a double surprise. First a sky-rocketing US market, and then (when least expected, of course) a spear-point top-out and the start of a primary bear market. When it comes to the stock market, nothing is guaranteed. But the preceding is a possible scenario for 1994, and it's the one that would be least expected.

Question: Russell, your scenario is certainly a dramatic one. But what are you doing about it?

Answer: Well, as I said, I think a stock market blow-off is certainly a possibility. But note that I am not betting on this scenario with a fat portfolio of stocks. I am basically out of common stocks (except for golds), and I have been suggesting that my subscribers be in roughly the same position. What I have done is buy calls, specifically, the March S&P 500 calls (these are not the SPX calls, they are the option calls on the futures). If this market is going to blow-off on the upside, it will probably do it in the first quarter of the year -- and the cheapest, highest leverage and safest way to play such a move is with the S&P calls.





But a warning -- do not get greedy. If you are not familiar with calls, then I would say, "Forget speculating for a blow-off. Options are a tricky and 'iffy' way of speculating, and only those who are thoroughly familiar with options should buy them."

Question: Russell, if your "premonition" is correct, how high do you think this market could go?

Answer: I have no idea, except to say, "Higher than anyone now thinks possible." Or let me put it another way, high enough so that today's unbelievably stubborn shorts will be forced to cover, and I mean cover en masse. Frankly, I don't know at what level this might be.

But one thing is clear. The way this market has been advancing so far has not frightened the shorts. In fact the quiet, low-volatility advances of 1992 and 1993 have kept the short sellers' hopes alive. The record number of uncovered shorts attests to that. But I emphasize -- with re-confirmation after re-confirmation of the bull market, no one who understands market action should be short. The fact that we have a record number of uncovered shorts in this market tells me that we have the formula for a technical explosion.

If this explosion does occur, frankly, I don't know whether it will drive the Dow to 3900 or 4200 or 5000. I have no idea. But the rise should be powerful enough, scary enough, convincing enough, to drive millions of shorts to cover. And that simply has not happened yet, not by a long-shot.

Question: I note that longer-term interest rates have risen as the bond market declined. I note also that the Utility Average has been declining sharply. In numerous previous studies you have stated that when the bonds and utilities go down together, the rest of the stock market goes down as well. In view of that, what do you make of the current situation?

Answer: History shows that when bonds and utilities go down in tandem, they almost always take the rest of the stock market with them. Therefore, the question here is whether the bond decline and the utility decline will continue or whether this is simply a first-step adjustment down in bonds and utilities. Let me put it another way -- if this is the beginning of a persistent decline in bonds and utilities, then all bets on an upside explosion are off, and the market will be under continuing pressure. But if this is just an initial adjustment towards higher rates, as soon as the bonds and utilities hit bottom, the stock market could still be set for an upside blow-off. My guess, the Fed will hold interest rates to the low side, and the bonds have probably seen their lows for a while.

Question: I hate to belabor the point, but you seem to attach an awful lot of significance to the record short interest on the NYSE and the Nasdaq. Why?

Answer: The short interest represents a barometer of speculative sentiment. What interests me is that (1) the short interests are at record highs, and (2) the short interests keep climbing. This phenomenon indicates that there is a stubborn belief on the part of a great many speculators that the market will "fall out of bed." Against this, we have a series of Dow Theory bull market confirmations. These confirmations should terrify the shorts, but that's simply not happening. What would finally panic the shorts and convince them that they are on the wrong side of the market and that they should get out? My guess -- an upside blow-off, a surge so strong that even the most stubborn short will buy, thus closing out his position.

Question: Russell, on another subject, you've recommended buying and holding gold shares and physical gold in the form of gold coins. Sixty years ago the US government passed a law making it a crime for its citizens to hold gold. Isn't it possible that the government could give us a repeat?

Answer: Well, anything is possible. But when the government called in the gold in the early 1930s they did it because they wanted to boost the Treasury's gold supplies. They also did it because they wanted to prevent a possible run on the Treasury's gold stock. But back in the early 1930s Americans were much more attuned to the value of gold as real money (in those days the dollar was "as good as gold"). Furthermore, in the '30s Americans were also much more law-abiding than they are today.

Since there are no gold (or silver) certificates outstanding today, and since the dollar is no longer a convertible currency (in other words, you can't turn in your dollars to the banks for gold), I don't think there is any chance that the government again forbids its citizens to own gold. Furthermore, I don't think there's any chance that the citizens of today would comply with a government order to turn in their gold. The world is a far different place in 1994 than it was in the 1930s. People have far less respect for government today. For instance, back in the '30s it was unheard of for a person to strike or shoot a policeman (now it's a daily occurrence). In other words, public sentiment and morality have totally changed. So stop worrying about a government call-in for gold. If you want to worry, I suggest you worry about whether you have enough gold.

Question: How much gold or how many gold shares or how many gold options should I own?

Answer: This is a very difficult question. A lot depends on your financial situation, a lot depends on your psychological make-up, and a lot depends on how thoroughly you believe in the gold bull market (if you believe in it at all).

Therefore, since I have 7,000 subscribers and probably 25,000 readers, there's no way I can come up with the perfect formula that covers everybody. So maybe I should just talk about how I personally operate.

First, I really believe that we're at the early stages of a major bull market in gold. From personal experience, I know that there are few situations as frustrating as this -- you do the work, you do the worrying, you (finally) thoroughly believe in what you see ahead, but you fail to take any action.

So let me tell you what I have done. First, I convinced myself that gold in the low 300s was selling at bargain levels. Consequently, I

started buying coins several years ago. Then, earlier this year, when I was thoroughly convinced (and I stated so in these Letters) that a gold bull market was underway, I bought calls on gold and started buying large quantities of gold shares.

Then, as profits mounted, I added to my gold positions (I still am adding). But it is important not to buy in the form of a "reverse-pyramid." In other words, your largest position in a bull market should be assumed early. Then each further addition to your total should be smaller than the preceding. Those who do the opposite -- in other words those who take an initial small position and then add increasingly larger amounts as the price action rises, these people take the chance of being wiped out on the first big reaction. So, do not add increasingly larger portions as the price rises -- it's the formula for a wipe out.

Finally, if you truly believe that you're in a bull market, you must ride it out. This is much more difficult than it sounds. It's difficult because (as I've written ad nauseum) the bull will try in every way to get you off his back. He wants to advance taking as few investors as possible with him.

Therefore, if you want to ride the bull you'll need patience and fortitude and a true belief in the bull market. This takes study, thinking, reasoning, stubbornness, and then more study and still more study.

Finally, as the bull market progresses, you'll eventually have the public on your side. When that happens it will feel "easy" to buy. And that's a signal that you're moving into the danger area. That's the place where it will pay you to start distributing. Let me put it this way -- if you buy early in a bull market and you've got white knuckles, you're probably buying right. If it's late in a bull market and you're selling and everybody is telling you that you're crazy, then you're probably right. It's the Russell rule of "reverse emotions," which states, "What feels right is probably wrong, what feels wrong is probably right."

Question: You keep talking about the federal debt. Well, the federal debt keeps growing, and nothing is happening. So Russell, why do you keep harping on debt?

Answer: Gross domestic product (GDP) does two things -- it expands or it contracts. But the national debt does only one thing -- it keeps growing. At some point somewhere ahead, even as the debt continues to grow, the GDP is going to turn down. Actually, the GDP doesn't have to turn down. It can just keep growing but at a far lesser rate than the debt. Given that scenario, at some point the pressure of debt will overpower GDP. When that happens, the nation will have to decide whether to inflate, and I mean inflate at a terrific rate -- or to take the pain of deflation and depression. I've felt that the nation will choose to inflate.

Remember, where corporations or individuals are concerned, unsustainable debt leads to bankruptcy. But where government is concerned, unsustainable debt leads to inflation or hyper-inflation.

Many years ago, one of my mentors, the brilliant Hamilton Bolton (he founded the *Bank Credit Analyst)* noted that in each succeeding economic cycle, it was taking more and more bank credit to produce less and less in the way of GDP in the US. Bolton's observation still stands. Thus we note that the Fed has been expanding bank reserves at a terrific rate for the past three years, and all the while the government has been running deficits at the rate of one billion dollars a day. This massive stimulation should have sent the economy through the roof, but the fact is that the US economy is still not really booming. True, under this enormous stimulation, the US economy is finally starting to push up, but look at the fantastic fiscal stimulation it's taken to get the economy chugging up again!

On top of all that, the US savings rate has held to absurdly low levels of around 3.5% to 4.5%. This means that consumers have been spending almost all their income, and this too has been a major stimulant for the economy. Actually, consumers (and they are finally beginning to feel good) are spending more than their income (in other words, they are borrowing in order to consume). Economists are warning that this state of affairs can't continue. We'll see.

So as I see it, the steady build-up of debt, particularly on the part of government, is guaranteeing that somewhere ahead inflation is fated to heat up and I mean really heat up. But will it happen? It already has. Gold sees it, silver sees it, platinum sees it, commodities see it, good quality jewelry sees it, top quality art sees it, much of housing sees it.

Question: Russell, a while back you recommended Hong Kong stocks, and in recent months the Hong Kong stock market has rocketed to new highs. What do you recommend now?

Answer: At this point I am a lot less intrigued with Hong Kong stocks and foreign stocks in general. I say this realizing that many foreign markets have gone hog wild on the upside, and I say this realizing that almost every "expert" is now recommending putting money into foreign stocks or into a few of the fast-multiplying foreign stock closed-end funds. Maybe it's just my inclination to do the opposite of what the crowd is doing, but that's the way I feel now. Personally, I've sold most of my Hong Kong stocks. The winner (and I have sold it) was Hang Seng Bank, and the bank was also my largest Hong Kong position.

Question: Would you buy S. African gold stocks?

Answer: Many of the S. African gold shares have enjoyed huge advances during 1993. Personally, I haven't bought any S. African shares on the basis of a policy I decided upon many years ago, and it's this: "*I don't like to buy potential problems.*" The politics of S. Africa have changed dramatically, and in April the blacks will have a majority in the S. African government. This may work out well or it may not work out at all. I honestly don't know. It's like asking whether China will be "nice" to Hong Kong when they take over in 1997. Who the devil knows? Therefore, I have not bought any S. African gold shares. If I did do anything on S. Africa, I would almost surely buy ASA (NYSE), a holding company for S. African gold shares (and a stock, by the way, that has been doing very well).

What's the downside of the S. African situation? Well, here's what columnist Malcolm Berko wrote a few weeks ago: "I wouldn't touch any S. African investment today. S. Africa is celebrating a peaceful change in political orientation. As a power transfers from the minority ruling party to the new majority, observers believe that S. Africa's economic and social structure will deteriorate. Inflation is expected to surge, business owners will shutter their shops, food and material shortages may occur, foreign investment could dry up, and S. Africa's most important asset -- educated and skilled professionals -- will leave the country." Russell comment: That's S. Africa according to Berko. Let's hope he's totally wrong.

INVESTMENT POSITION: The bull remains in the box. There's no way I could take him out, not with numerous recent bull market re-confirmations by the D-J Industrials and Transports. Will the bull market follow the "Russell orders" and blow-off on the upside? If I knew for certain, I'd be the richest man in the Western hemisphere (many years ago, Hollywood made a film about a man who could see 24 hours ahead. As I remember, that gift got him into big trouble, but yeah, I could handle it).

Gold is still floating around under the 390 area, and I just got a longer term buy signal on the Swiss franc. Bonds have firmed up surprisingly well, aided by good news from Uncle Sam on inflation. Aside from my position in gold and gold shares, I don't have much of a position in anything else. I do have a batch of those

March 500 S&P options, but that's just a rank speculation on the possibility of a blow-off (and the blow-off will have to arrive fairly soon). By the way, these are options on the S&P 500 futures, NOT options on the S&P 100). Does it make sense to be basically out of stocks but speculating on an upside blow-off? Who knows, but that's what I've done. Aside from those two positions, I'm standing aside, playing the part of the interested observer.

NOTES & QUOTES: In a matter of weeks, Congress will begin debating that most explosive of issues, the balanced-budget amendment to the US Constitution. The proposed amendment, which would go into effect in 1999, states that federal outlays cannot exceed receipts, nor can the national debt be raised unless three-fifths of the members of both houses agree. The president must also submit a balanced budget (which hasn't happened in decades).

Is there any chance this bill could pass? I think there is. In 1992 the House voted 280 to 153 in favor of a similar amendment, just short of the 289 needed to pass. In 1986 the Senate voted 66 to 34 in favor, one vote short of passing. The amendment would require ratification by three-quarters (38) of the states. The pressure for an amendment "fix" is greater now than ever before. And the public is tired of hearing about deficits and debts. Yes, the amendment could pass.

What would passage of the amendment mean? I can't imagine. Today the US economy is struggling upwards, this with the help of super-low synthetic interest rates and the massive stimulation of $350 billion in annual deficits. Eliminate the deficits? Are you serious? A monster deflationary squeeze would be on. Every government agency would be decimated, the military would be fractured. All hell would break lose. Senator Robert Byrd ridicules the whole thing (meaning he knows what it would entail). Byrd asks, "Why not just have a Constitutional amendment that says, 'The members of Congress shall have a spine?'" Russell comment: It's too late, Senator, they should have been using their spines 40 years ago. Now the whole mess is out of control. It's inflate or die. If we continue on our current path, it's inflation, then hyper-inflation. If we pass an amendment outlawing federal deficits, it's a depression (dying). Take your choice. I wish I knew a painless answer.

* *

Back in 1981 the kings of market value were AT&T (at $47 billion), IBM ($34 billion), Exxon ($27 billion) and GE ($13 billion). How times have changed. Here are 1993's highest market value stocks: GE ($89 billion), Exxon ($78 billion), AT&T ($71 billion), and Coca-Cola ($58 billion).

* *

Secrets: I distrust almost all secrets, particularly when they stem from government. After all, people in government work for us, we pay them, so where the hell do they get off being secretive about their actions? The Clintons, who campaigned on open government, are turning out to be the king and queen of secretiveness. First, we have Hillary's top secret "meeting of the 500" on health. Then we have the annual Renaissance weekend at Hilton Head, S.C., which took place a few weeks ago. The Clintons demanded secretiveness on all that was said there, in a performance that the *NY Times* (Jan. 4) termed "a degrading spectacle for a number of journalists." The *Times* continued, "These journalists are promising to keep quiet about comments made before a hand-picked elite of several hundred people on issues of profound importance . . . for two years in a row we have seen a dozen or so employees of news organizations muzzle themselves as the price of social acceptance at the Clintons' table."

Now we have the best secret of all -- what the devil happened back in Arkansas when Bill Clinton was governor? Well, here's what I've learned so far from the Clinton-Whitewater affair. (1) The whole thing could turn out to be a real mess. (2) A lot of documents and papers are missing -- maybe on purpose. (3) Vince Foster, the Clintons' personal lawyer, must have been avoiding something major when he committed suicide. (4) The White House sure grabbed the Whitewater papers out of Vince's office fast -- even before Vince's body was cold. (5) Hillary knows more about the whole affair than Bill does. (6) Hillary's Arkansas law firm has got to be embarrassed by what's happening, to say the least. (7) The feeling is that if you go after Whitewater, you're now going after the Prez's wife, and that's always dicey, particularly if you're a politician. (8) Republican John Dole is one tough hombre, and, by the way, he never did like or trust Clinton. (9) Attorney General Janet Reno has lost all credibility as far as I'm concerned. She comes across as a White House lackey and a wimp.

* *

All is not lost. The $4 billion dietary supplement industry can breathe a little easier. The FDA will not ban assorted vitamins and supplements, they will, instead, insist that certain claims for health be proved. This, however, will mean large added costs for many producers, but it's a lot better than an FDA outright ban on certain supplements that the FDA for some reason or another disapproves of. Congress could still water down the latest FDA requirements when it reconvenes.

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The World Bank annual review of 207 nations states that Switzerland is still the world's richest nation, with a GNP per capita income of $36,230, while Mozambique is the world's poorest country with a GNP per capita income of $60.

* *

I've received an awful lot of letters regarding my statements about blacks, black youth and prisons. I stated that the only solution I see to the problem is for black leaders to lead (and no -- I don't think imprisoning a whole generation of young blacks is going to solve the problem). Why do I write about this situation at all? I'm writing about it because it's one of the greatest problems facing this nation today. Ken Hamblin (he's a black commentator featured on radio KNUS in Denver) is talking straight. Here's what he says, "We are teaching black kids that they are victims -- the only victims -- and that everything that goes wrong in life is part of a racial conspiracy (he calls this the 'blame whitey' syndrome). We are teaching them to be hostile, and it's leading to a kind of xenophobia. I want to know why 60% of black babies are born out of wedlock. Is that the fault of white people? I want to know why so many black kids can't speak proper English. I want to know why black people can't pass a civil service examination. The excuse is that it's culturally biased. Well, I'd like to know what could be culturally biased on a test for firefighter. Quotas and affirmative action are killing us. It's a system that says if you're black, then we won't expect so much of you, we won't challenge you. Well, damn it, I think it's time we start demanding, challenging, expecting. If we fail we fail. We've come to a point where every time a white person sees a black person in a job, they assume it's affirmative action. Do you know how demeaning that is?"

Russell comment: To my mind, this kind of talk represents the hope for black America. Today a lot of black kids think that any kind of education is "whitey's thing," and therefore the hell with it. That kind of thinking guarantees the continuance of a black underclass, absolutely guarantees it. If you want a real insight into the gangs, read ICE-T's article on the gangs in the current issue of *Playboy*.

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For a pure mass of valuable information about almost every area of investing, my favorite, hands down, is *"Dunn & Bradstreet's Guide to Your Investments, 1994."* The soft-bound volume (406 pages) sells for $17, and the new addition is now at the bookstores. It's edited by my old friend, Nancy Dunnan. How Nancy writes this book and updates it yearly is beyond me. It's a treasury of info, and I highly recommend it.

* *

Writing about Clinton's medical thesis, Caspar Weinberger (*Forbes*, Jan. 17) reminisces, "Remember that shortly before Medicare was enacted in 1965, President Johnson was told it would cost about half a billion dollars a year when fully implemented? But when the program went into effect, the actual cost for the first full year was $6.5 billion. Medicare and Medicaid together were projected to cost $20 billion by 1990. That was not quite right. The actual cost by 1990 exceed $186 billion. The Administration's estimate for Medicare alone for 1993 is $132.8 billion. That is quite a precise estimate of what is likely to total at least $135 billion. The lesson? Beware of this Administration's

sugar-coated rhetoric, designed to lull your worries as to whether President Clinton is a big spender." Russell comment: It's amazing -- even as South America and Europe (and even China) move away from the welfare state, the US moves further and further towards it.

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A letter from a London subscriber H.W.: "Dear Mr. Russell, in reference your Dec. 8 issue: In Switzerland every man is obliged to serve in the armed forces, after which he takes his gun home where he keeps it to age 65 in readiness for being called to war. The Swiss have extremely low crime statistics, which only proves your point that it is not the guns out there but the social, economic and psychological problems. I agree with you. Reader for over 15 years, yours truly, H.W."

* *

What was the hottest stock market in 1993? Would you believe -- Poland. From December 31, 1992 to December 23, 1993, the three-year old Polish market (Warsaw trading index) rose from 1,000 to 12,105 in dollar terms. One factor, the Warsaw market had only 22 stocks to trade in, so Poles didn't have a lot of places to put their money. Among the bigger markets, Brazil and Turkey were the winner.

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Californians evidently don't believe that getting rid of their guns will make the world a safer place for them. Out on a shopping spree in 1993, citizens of the Golden State bought a record 665,000 firearms, according to documents filed with the state's Department of Justice. California, by the way, has a 15-day waiting period for purchase of a handgun.

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Sindlinger & Co. in a FAX received last week notes that their cost-of-living index for this year was up against last year by 8.37%. The news is not all bad, however. The recent peak of the year-to-year comparisons occurred in November of 1991 -- at that time the cost-of-living index was 14.7% above the same month in 1990. In other words, we're still experiencing inflation, but at a lower year-to-year rate.

* *

This from *Jack Anderson Confidential*, "It's with somber heart that I can now report that Saddam Hussein is back . . . The country was decimated, its military infrastructure in disarray. But Saddam has rebuilt and is emerging again -- despite the Desert Storm loss and a crippling oil and trade embargo -- as the strongman of the Middle East. He has 400,000 men in arms. More than 2,000 main battle tanks are operational again. Along with 2,500 armored personnel carriers. He has 1,650 artillery pieces and more than 300 fixed-wing aircraft." Russell comment: Bush's cowardly (political) decision not to go all the way and capture Saddam may prove to be one of the worst mistakes since Vietnam.

* *

I very seldom read novels: the reason -- I don't have the time and I always feel (probably arrogantly) that if need be I could dream up just as good stories myself. But my wife, Faye, she just eats novels up. I usually buy her any late novel that she requests -- I simply grab the book, put it on the bookstore bill, and that's that. The other day I bought Michael Crichton's latest output, a thing called "Disclosure." This time I looked at the price - 24 bucks plus tax. I couldn't believe it. "What happened to the $3.95 hardback," I asked the clerk. He gave me a pitying look, as if to say, "What century were you born in, Buddy?" Then a few days ago I bought a fairly new paperback, William Coughlin's "In the Presence of Enemies." The paperback was $5.99 plus tax. I asked the clerk, "What happened to the 95 cent paperback, you know, the classic money saver?" The clerk stuttered, "Gee, I didn't know they were ever that cheap. Are you serious?" I told him that I guess inflation had crept up on me while I wasn't looking. Faye finished both books in four days. I wish she'd read slower.

* *

Night-Life in California: The other night about 3AM we heard a rattling in the back of the house. Faye sat up in bed and whispered, "I think someone's trying to break into the house?" I replied, "Nobody with any brains would make that much noise breaking in -- I, uh guess." So I grabbed a Sig-Sauer pistol in one hand and a large flashlight in the other. Tip-toeing out the back door I headed towards the scuffling sound and suddenly turned on the flashlight. There, about five feet in front of me was the largest skunk I've ever seen. He was positioned rear-end toward me with his tail up high. I said, "Oops, nice fella," and I backed away very slowly. With that Mr. skunk turned around and trotted off into the night. I went back to bed, thanking my lucky stars that it wasn't a very nervous skunk.

* *

Every once in a while I read a letter in an op-ed column of some newspaper (I read 10 newspapers a day) that makes me smile. This one, printed a few weeks ago in the *San Diego Union,* is worth reading.

> I am having fun offering to pay for merchandise with Federal Reserve vouchers. Store clerks look blank and call the manager to get a ruling.
>
> "Federal Reserve vouchers?" The manager will repeat, questioning my sanity. "I don't know if I've seen one of those. Do I sign for them or something?"
>
> Well, no, I tell him or her, these are notes issued by the government, based on the full faith and credit of the United States of America.
>
> "May I see what one looks like?" I am asked.
>
> "Certainly," I reply. Then I offer a $10 bill — or whatever, depending on the purchase. "Will this be all right?"
>
> Surprise, and sudden realization, light up faces all around, "Oh! You mean cash!"
>
> Right! Cash money, American, paper money, legal tender; transferable because sellers will accept it, worth less than clamshells or wild boar bones by itself. But we Americans haven't snapped to that yet.
>
> We ignore the fact that a note is a debt instrument; an IOU, no matter who or what institution issues it. Paper "money" is redeemable from the government, at any bank, for absolutely nothing other than more paper "money." The bank won't even give you clamshells or wild boar bones for your bills. Our paper and coin currency is pure imagination at work.
>
> ENNIS McFARLAND
> *San Diego*

PRE-DETERMINATION IN THE MARKETS: A lot of my fellow investment advisors and market letter writers aren't going to like what I say next. But here goes -- the more I study the market (and it's been longer than I like to think about) the less I depend on pre-determination techniques such as astrological dates, cycles, decennial patterns, waves, Fibonacci dates, etc.

What I do believe in is this -- once a bull market is born, once the primary trend of any item or market turns up, that trend goes to conclusion. The only mystery is how it's going to get there. The same holds true when the primary trend turns down and a bear market starts. The trick, the real trick is to be able to identify a major turn -- and then to figure out the path to that trend's final conclusion.

Furthermore, once the primary trend is established you can forget all the pre-determination signals, the cycle dates, the waves and the presumed wave endings -- just remember that the trend will end, as it always does, in exhaustion and most of the pre-determined signals won't work or at worst they will throw you off in your investing.

Today is a pretty good example. After much thinking and pondering, I've concluded that this bull market "should not" end with a record short interest and with this much caution and skepticism, regardless of overvaluation, regardless of "the end of the wave" or the finale of the four-year presidential cycle or any other "map of the future."

This market, it seems, is due to end only in exhaustion. What would be a definitive sign of exhaustion? I'm not completely sure, but I think a very valid indication would be a routing of the bears --

as seen in a major, dramatic collapse of the short interest and a dramatic contraction in the value of NYSE margin accounts.

Of course, the other indication of an end to the bull market would be a bona fide Dow Theory bear signal, and we've had no sign of that yet.

So until I see an obvious rout of the shorts or a Dow Theory bear signal, I'm betting on a continuation of the bull market. How long can this bull market go on? Nobody knows, but forget prediction, let's turn to identification. The bull market will last as long as it takes to foment a major panic on the part of short sellers. I don't know what could panic the stubborn shorts -- except -- except a dramatic, spectacular explosion on the upside.

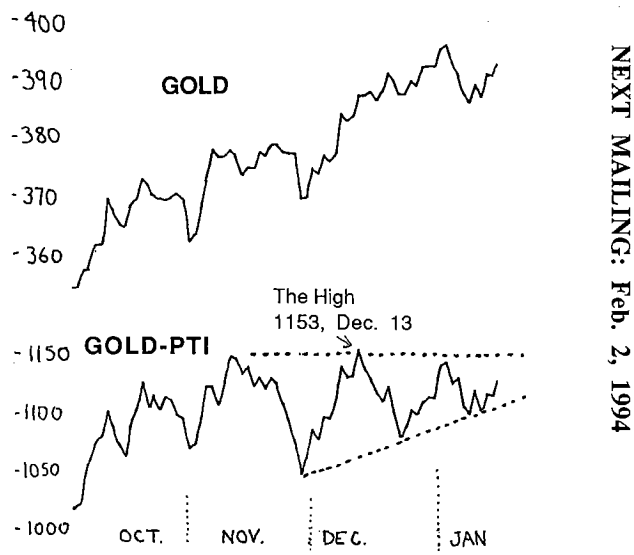
GOLD: Gold continues to bounce around in the 390 (and hopefully above) area. Even though the pattern has been tedious (and sometimes nerve-wracking), there's really nothing wrong with this kind of action. Looking at the longer-term (as opposed to the daily) picture, it means that the price of the metal is continuing to rise erratically. But at the same time the rise never draws any particular attention -- and it certainly doesn't make any dramatic headlines. In a nutshell, it means that gold has been pushing higher without benefit of the public.

Last week I asked Leon, my local La Jolla coin dealer, whether he is experiencing any increased buying activity in gold coins. His answer, "It's been real quiet. The only buyers are my regular customers, the people who buy 5 or 10 coins each and every month -- you know, the accumulators. But if you're asking if it's anything like 1978 or '79, the answer is no way. As far as the coin-buying public is concerned, gold doesn't exist." All of which tells me that this second phase of the gold bull market is just getting started.

I'm getting more and more respect for my new Gold Primary Trend Index (G-PTI). Why? It just seems to tell the right story. Let's study the chart. Note that the high for the G-PTI was recorded on December 13 at 1153. At that point the Index had formed a double-top, but from December 13 on, the G-PTI refused to confirm the steady climb of the gold metal.

I've drawn dotted lines which show that the G-PTI appears to have formed a bullish "ascending triangle." This is a formation with a flat top, but with each decline terminating at a higher level than the preceding. Ultimately, ascending triangles tend to break out on the upside. If I'm correct in this analysis, the G-PTI should push out above 1153.

So the current technical problem for the golds boils down to this -- my G-PTI must climb to a new high above 1153. Looking at the chart, it's clear that since mid-December the 1153 level on the G-PTI offered important resistance to further upside progress. But if the G-PTI can rally above the 1153 area, the whole gold spectrum should embark on a strong advance to and then above 400.



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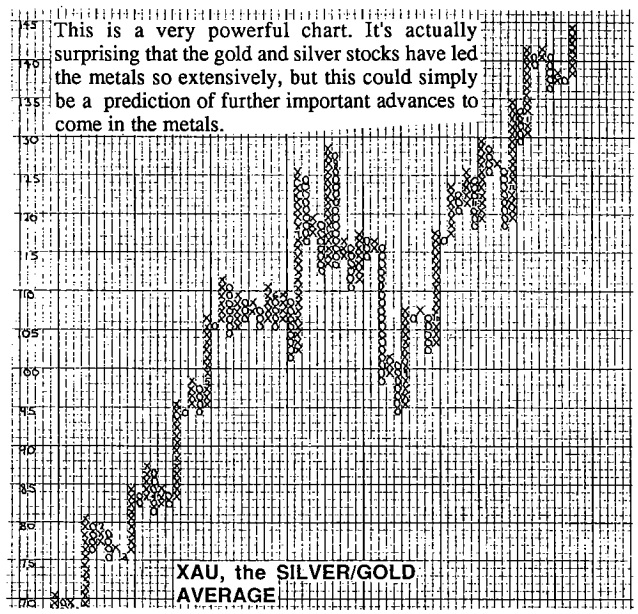
Note: I've always said that there are no geniuses in the investing business, only geniuses for a while. The world's current genius is undoubtedly George Soros, the man who made a billion dollars (and became famous) in 1993 by speculating on the fall of the pound. Last April Soros moved into the gold market (gold was below 350). He bought a 10% interest in Newmont Mining (a US gold mining company, but you knew that) for a reputed $38 a share. Ah, but George Soros is evidently long-term bullish on gold. Despite gold's retreat from last August's high of 407, Soros increased his position in Newmont to 14.7%. If you're a gold-bug, how can you hate it? (By the way, how come they never call people who prefer paper -- dollar bugs?)

I include here my point & figure chart of the Silver/Gold Average, and the reading continues bullish. The 1993 high for XAU was 140, and as this is written XAU is again attacking that high (read Late Notes). By the way, if you want to follow **XAU,** the price is flashed on the CNBC tape about every three minutes all day long.


This is a very powerful chart. It's actually surprising that the gold and silver stocks have led the metals so extensively, but this could simply be a prediction of further important advances to come in the metals.
XAU, the SILVER/GOLD AVERAGE

I find it fascinating to read the many uninformed comments which run, "Hey, there's no inflation, so how can gold go up?" Answer, gold is probably more interested in the future of paper money than it is in whether the CPI is up or down this month. Consider this -- the Clinton program is basically anti-business and punishes the "rich." This puts the onus on fiscal and monetary policy to keep the economy going. US monetary policy boils down to low, low interest rates and pump, pump, pump at the Fed. Fiscal policy is -- run big deficits but promise that "you'll try to do better." Both policies are conducive to a bull market in gold.

I continue to receive inquiries about which gold mutual funds to buy. I like the Benham Gold Equities Index [(800) 321-8321 or (415) 965-8300], the Lexington Gold Fund [(800) 526-0056] and Invesco Strategic Gold [(800) 525-8085]. All three are no load.

LATE NOTES: The repeated Dow highs are now rubbing off on most of the other major averages. For instance, on Jan. 14 we saw new highs in the D-J Industrials, Transports, D-J 65, NYSE Composite, S&P Financials, S&P Industrials, MidCap 400, Amex, NMS Composite, Nasdaq Composite, Nasdaq Industrials, Value Line Composite, Wilshire 5000. This is written before the close, but as this is written the XAU is above 143, which would be an upside breakout for the Silver/Gold Average . . . I was lying on my coach reading the WSJ at 4:30AM when I felt that Jan. 17 earthquake. If you've never experienced your whole house rolling back and forth, well you've missed a real thrill. But thankfully, no damage in San Diego, LA got it all. 1994's starting off with a bang.